

ST 96-35

Tax Type: SALES TAX

Issue: Nexus/Taxable Connection With Or Event Within State

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	
)	
v.)	Docket #
)	
TAXPAYER)	IBT #
)	
Taxpayer)	

RECOMMENDATION FOR DISPOSITION

APPEARANCES

Thomas M. Newmark and Melanie R. King for TAXPAYER.

SYNOPSIS

This cause came on for hearing following a Retailers' Occupation and Use Tax audit performed upon TAXPAYER (hereinafter "taxpayer") by the Illinois Department of Revenue (hereinafter the "Department") for the period of July 1, 1981 through December 31, 1988. After completion of her audit work, the auditor and her supervisor reviewed the audit findings with representatives of taxpayer who indicated disagreement with them. Taxpayer does not agree to its liability under the audit findings primarily on the basis that as a Missouri business it lacked sufficient contacts with the State of Illinois to be required to collect and remit Illinois Use Tax on its sales to Illinois customers.

After reviewing this matter, I recommend the issues be resolved partly in favor of the taxpayer and partly in favor of the Department.

FINDINGS OF FACT

1. Taxpayer conducted business operations in Missouri during the audit period by selling furniture at retail. (Tr. p. 39)

2. During the audit period taxpayer made sales of furniture to Illinois customers who traveled to its store at Ballwin, Missouri. (Tr. pp. 30, 39)

3. The taxpayer delivered the furniture it sold to Illinois residents through its delivery carrier, CARRIER (hereinafter "CARRIER"). (Tr. pp. 14-18, 28-30)

4. Taxpayer introduced documentary evidence at hearing to show that the prepping, deluxing, and finishing responsibilities of CARRIER for the furniture it delivered began on or about August 1, 1988. (Tr. pp. 15-16, 22, 26-27; Taxpayer Ex. No. 3)

5. Taxpayer was the corporate parent of PARENT, a furniture store in Fairview Heights, Illinois. (Dept. Ex. No. 8, p. 34; Taxpayer Ex. No. 4)

6. PARENT began operating a furniture store in Fairview Heights, Illinois on May 23, 1986. (Tr. p. 37) Taxpayer and this Illinois furniture store held themselves out to the public as members of an affiliated group of "Carafiols" stores with different locations. (Dept. Ex. No. 8, pp. 41-43; Taxpayer Ex. No. 2)

7. PRESIDENT was the President of all the separately incorporated furniture stores who did business under the name of "PARENT". (Tr. p. 34)

8. VICE PRESIDENT was Vice President of all the separately incorporated furniture stores who did business under the name of "PARENT". (Tr. p. 49)

9. Pursuant to statutory authority, the auditor did cause to be issued a Correction and/or Determination of Tax Due (SC-10) and this served as the basis for Notice of Tax Liability (NTL) No. XXXXX issued November 8, 1989 for \$123,437.20, inclusive of tax, penalty and interest. (Dept. Ex. Nos. 4 and 6)

10. The introduction of the Department's corrected return and NTL into evidence established its *prima facie* case. (Tr. p. 11; Dept. Ex. Nos. 4 and 6)

CONCLUSIONS OF LAW

The issue for decision in this case is if taxpayer was required to collect and remit Illinois Use Tax to the Department from its sales of furniture or other tangible personal property to Illinois customers. Section 3-45 of the Use Tax Act imposes a use tax collection responsibility upon retailers "maintaining a place of business in this State" 35 ILCS 105/3-45. The Act defines a "Retailer maintaining a place of business in this State" to include any retailer:

"Having or maintaining within this State, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this State under the authority of the retailer or its subsidiary, irrespective of whether such place of business or agent or other representative is located here permanently or temporarily, or whether such retailer or subsidiary is licensed to do business in this State" (emphasis added) 35 ILCS 105/2

The Department's administration of these provisions of the Illinois Use Tax Act is subject to the interpretive guidance of the courts. This area of the law regarding what amount of economic activity in the taxing state, or nexus, is sufficient for that state to tax a business, has produced substantial case law.

In National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), the United States Supreme Court held the Department's application of Section 3 of the Illinois Use Tax Act to tax an out-of-state mail-order seller as unconstitutional where the seller's only connection with customers in Illinois was by common carrier or the U.S mail. The Bellas Hess decision held the Department's effort to assess tax violated the Due Process Clause of the Fourteenth Amendment to the U.S. constitution and created an unconstitutional burden on interstate commerce.

Subsequent to Bellas Hess, the U.S. Supreme Court analyzed the Commerce Clause and concluded that the Constitution confers no immunity from State taxation and interstate commerce must bear its fair share of the State tax burden. Washington Revenue Dept. v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978); Japan Line Ltd. v. County of Los Angeles, 441 U.S. 434, 444 (1979); Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, (1995).

As long as the conditions of the four-prong test established by the U.S. Supreme Court in Complete Auto Transit v. Brady (1977), 430 U.S. 274, 279, are fulfilled, no impermissible burden on interstate commerce will exist. These four prongs are whether the tax:

- (1) is applied to an activity with a substantial nexus to the taxing state;
- (2) is fairly apportioned;
- (3) does not discriminate against interstate commerce; and
- (4) is fairly related to the services provided by the State.

The Supreme Court in Quill Corp. v. North Dakota, 112 S. Ct. 1904 (1992) noted the Due Process Clause and the Commerce Clause reflect different constitutional concerns and are analytically distinct, Quill, 112 S. Ct. at 1909, because the Due Process Clause is based on concepts of "notice" and "fair warning" whereas the purpose of Commerce Clause requirements, including nexus, are based upon structural concerns about the effects of state regulation on interstate commerce, Quill, 112 S. Ct. at 1913. The court overruled its Bellas Hess due process holding by finding that physical presence is no longer required to subject out-of-state retailers to a state's taxing authority so long as the seller maintains minimum contacts in the taxing state. The court also held that a business could satisfy the "minimum contacts" required for due process, such as when Quill directed its selling activities at North Dakota residents, and yet lack the substantial nexus with the taxing state (required under prong (1) of Complete Auto Transit), Quill, 112 S. Ct. 1911, 1913-1914.

In Quill, the Supreme Court expressed its reluctance to overrule its commerce clause holding in Bellas Hess based on reliance by state governments and businesses, but made clear that Congress could authorize use tax collection duties upon out-of-state retailers, and noted that any reluctance by Congress to do so should not be conditioned on an assumption that the Due Process Clause holding in Bellas Hess prohibited Congress from burdening interstate mail-order concerns with a duty to collect use taxes. In connection therewith, the court

reaffirmed that its Commerce Clause physical presence rule in Bellas Hess continues to provide a "bright-line" test in this area, Quill, at 1916. Recently, the Illinois Supreme Court in Browns Furniture, Inc. v. Wagner, No. 78195 (1996 Ill. Lexis 58), held that an out-of-state furniture seller who used its own employees and trucks to make more than occasional deliveries to Illinois customers satisfied the bright line test and was therefore subject to the Illinois use tax collection responsibility asserted by the Department.

After reviewing the facts in the instant case and applying the statutory provisions as interpreted by case law, I conclude taxpayer did not have substantial nexus with Illinois until May 23, 1986, when the Illinois PARENT store was opened. Taxpayer's operation of a corporate subsidiary retail store in Illinois constitutes a physical presence that I find to be substantial nexus.

Taxpayer argues that because it and the Illinois store were separate corporations, Illinois nexus should be negated on its part. I do not agree, as part of the documentary evidence in this case shows that taxpayer and the Illinois PARENT stores were holding themselves out to the public as one entity with different locations. Different St. Louis newspaper advertisements show taxpayer presenting itself under one name - "PARENT", as well as showing pictures of the common officers VICE PRESIDENT and PRESIDENT and listing identical hours and credit terms for all locations, including the one in Illinois (Dept. Ex. No. 8, pp. 41-43). In its contract with carrier CARRIER, the taxpayer signed and executed it on behalf of the entire group of stores, and when CARRIER corresponded with taxpayer regarding the contract terms, the letters were addressed to "PARENT" or "PARENT Inc." (Taxpayer Ex. No. 2), and not to the individual corporations.

Taxpayer has cited some cases for its position that the operation of the subsidiary Illinois store under a separate corporate existence did not create nexus for it. While it is true the courts in SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666 (Conn. 1991); SFA Folio Collections, Inc. v. Tracy, 652 N.E. 2d 693 (Ohio 1995) and Current, Inc. v. California Board of Equalization,

29 Cal. Rptr. 2d 407 (Cal. App. 1 Dist. 1994) did not conclude there was substantial nexus, I find these decisions distinguishable as not one of them involved a situation as exists here, where a group of stores was holding itself out to the public under one common name. While it is true in the Folio cases that the taxpayer was licensed to use the name of Saks Fifth Avenue, the parent corporation and subsidiary were not holding themselves out to the public through the media and otherwise as one business under the same name. In Current, the parent corporation, although maintaining a physical presence in California, was conducting operations under the different name of "Deluxe." Other distinctions between the Current facts and those herein are that Current and Deluxe did not have identical management, and did not operate the same or a similar line of business. In the case of Bloomington's By Mail, Ltd., v. Commonwealth of Pa. Dept. of Revenue, 591 A.2d 1047 (Pa. 1991), aff'd 567 A.2d 773 (Pa. Commw. Ct. 1989), also relied upon by taxpayer, the state pointed out to the court how the in-state and out-of-state corporate affiliates used the same advertising themes and motifs. In rejecting this the court said "Absent something more, this Court fails to see how such a similarity can constitute a nexus for use tax purposes." 567 A.2d at 778. I find the "something more" exists herein and it is the identification of taxpayer and the Illinois store to the public under the common "PARENT" name. This fact and the identical business objectives, identical product lines, identical business hours, along with the same officers and management, causes me to conclude that taxpayer had substantial nexus with Illinois through its operation of the subsidiary Illinois store in Illinois.

Although taxpayer submitted corporate certificates of good standing on itself and the Illinois store from the corporation division of the Missouri and Illinois secretary of state, these were the only documents tendered at hearing by taxpayer on this issue. While taxpayer's witness offered testimony at hearing about it and the Illinois corporation having separate general ledgers, financial statements, and other documents, none of these documents were produced at hearing. Taxpayer's failure to produce their records permits a negative

inference that if the records had been produced, they would have reflected unfavorably on their position. Smith v. Department of Revenue, 143 Ill.App. 3d 607, 613 (Fifth Dist. 1986); Lakeland Construction Co. v. Department of Revenue, 62 Ill.App. 3d 1036, 1039 (Second Dist. 1978). When I asked PRESIDENT, President, if a customer could order a piece of furniture from one of the Missouri stores though the Illinois store, his response was that he didn't remember. (Tr. 46) I find this response somewhat surprising, considering the position of this witness in all the corporations, although the lack of memory on this may have been influenced by knowledge that an affirmative response to this question would have been contrary to the separate corporate identity position argued by taxpayer.

Taxpayer was the corporate parent of the Illinois store, PARENT and the Illinois Supreme Court has found nexus for an out-of-state corporate retailer who has subsidiaries operating in Illinois, Reader's Digest Ass'n v. Mahin, 44 Ill.2d 354 (1970).

In summary, I find that the liability assessed against taxpayer on and after May 23, 1996 should stand as determined by the auditor. I also find the evidence produced by taxpayer at hearing is sufficient to recommend an abatement of penalty in this case due to reasonable cause.

RECOMMENDATION

Based upon my findings and conclusions as stated above, I recommend the Department reduce NTL No. XXXXX and issue a Final Assessment.

Karl W. Betz,
Administrative Law Judge